



**CYPRUS SECURITIES AND EXCHANGE COMMISSION**

## **Consultation Paper**

**No. IF (2006-01)**

**February 2006**

## **PART I**

### **Introduction**

1. The Cyprus Securities and Exchange Commission ('the Commission'), taking into consideration the provisions of the European Directive 2000/12/EC ('the European Directive') relating to the taking up and pursuit of the business of credit institutions, has proceeded with the re-examination of Part I [Monitoring and Control of Exposures to Clients or Directors of Investment Firms ('the IFs') and their Connected Persons] of the Investment Firms Directive 7/2003 ('the Commission's Directive') regarding the capital adequacy of IFs.
2. The Commission, before deciding on the final amendments of Part I of the Commission's Directive, invites your comments and suggestions in relation to the present Consultation Paper.

Kindly note that your comments and suggestions should refer to Sections 3, 5, and 6 of Part II of the present Consultation Paper, as these are related to the provisions of the European Directive which give the right to Member States to exercise their discretion at the implementation stage. Sections 1, 2 and 4 of Part II of the present Consultation Paper refer to provisions of the European Directive that are mandatory to be adopted as they are.

3. Deadline for the submission of comments

We kindly request you to send your comments and suggestions to the Commission by **March 13, 2006, the latest**.

4. Further information

For further information please contact Ms Eftychia Georgiou or Ms Klelia Christophorou, Officers of the Commission, tel. 22 875475, fax. 22 754671, email address: [investmentfirms@cysec.gov.cy](mailto:investmentfirms@cysec.gov.cy).

## **PART II**

### **Consultation Paper**

#### **1. Interim Profits**

##### 1.1 European Directive

Article 34(2) (2) of the European Directive states that «*Member States may permit inclusion of interim profits before a formal decision has been taken only if these profits have been verified by persons responsible for the auditing of the accounts and if it is proved to the satisfaction of the competent authorities that the amount thereof has been evaluated in accordance with the principles set out in Directive 86/635/EEC and is net of any foreseeable charge or dividend*».

##### 1.2 Amendment of the Commission's Directive

The Commission intends to amend Section 8 (Interim Profits) and Appendix A, A.3(c) of Part II (Computation of Capital Base of CIFs), as well as the Computation of Eligible Own Funds of Appendix C, Part IV (Capital adequacy) of the Commission's Directive so that the provisions of the European Directive stated in part 1.1 above to be adopted. In particular, upon the above amendments, the inclusion of interim profits in the computation of the capital base (own funds) will be allowed only if they are audited.

It is noted that the Commission does not intend, currently, to amend Section 20 of the Investment Firms Laws of 2002-2005, which states that a CIF should submit to the Commission its yearly report audited by independent and approved auditors, once a year.

#### **2. Capital base (own funds) for purposes of monitoring and control large exposures**

##### 2.1 Amendment of the Commission's Directive

Given the amendment of the Commission's Directive of part (1) above, paragraph 5 of Section 2 (Clarifications) of Part I of the Commission's Directive will be amendment so that the capital base, which will be used for purposes of monitoring and control large exposures is the one based on the recent audited accounts of the CIF (the phrase 'half-yearly or annual' will be deleted).

#### **3. Exemptions of exposures**

##### 3.1 European Directive

Article 49(7) of the European Directive states that Member States may fully or partially exempt, from the application of limits provided in relation to large exposures, the exposures stated in column (1) of the attached Appendix A.

### 3.2 Amendment of the Commission's Directive

The Commission intends to amend the Commission's Directive so that the exposures stated in column (2) of the attached Appendix A to be exempted from the application of the limits stated in Section 3 of Part I of the Commission's Directive.

## 4. Non exposures

### 4.1 European Directive

Article 1(24) (exposures) of the European Directive states that «*exposures shall not include*»:

*(a) in the case of foreign exchange transactions, exposures incurred in the ordinary course of settlement during the 48 hours following payment.*

*(b) in the case of transactions for the purchase or sale of securities, exposures incurred in the ordinary course of settlement during the five working days following payment or delivery of the securities, whichever is the earlier».*

### 4.2 Amendment of the Commission's Directive

The Commission intends to amend the Commission's Directive so that the provisions of the European Directive stated in part 4.1 above, to be adopted. As far as part 4.1(b) above concerned, it is clarified that in the case where the settlement is done in a period less than five working days (i.e. Cyprus Stock Exchange), is taken into consideration this period and not the five working days.

## 5 Limits on exposures

### 5.1 European Directive

Article 49(2) of the European Directive states that «*where that client or group of connected clients is the parent undertaking or subsidiary of the credit institution and/or one or more subsidiaries of that parent undertaking, the percentage laid down in paragraph 1 (that is 25%) shall be reduced to 20 %. Member States may, however, exempt the exposures incurred to such clients from the 20 % limit if they provide for specific monitoring of such exposures by other measures or procedures. They shall inform the Commission and the Banking Advisory Committee of the content of such measures or procedure*».

In addition, Article 49(4) of the European Directive states that '*member states may impose limits more stringent than those laid down in paragraphs....,2 and....*'.

### 5.2 Amendment of the Commission's Directive

The Commission intends to amend Section 3 (Limits on Exposures) and the tables of Appendix C of Part I of the Commission's Directive by adding a new limit, which will state that CIFs are not permitted to allow the total value of exposures in

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respect to the persons referred to part 5.1 above to exceed the 20% of its capital base (own funds).

## **6 Balances with related companies**

The Commission intends to withdraw the following condition from all CIFs' authorisations:

*'The Company must provide immediately a confirmation that the transactions with related companies will be at arm's length and, under no circumstances, there will be substantial balances between them'.*

**APPENDIX A**  
**Exposure Limits**

(Note: The amendments from the European Directive are stated in bold letters)

	<b>Column (1)</b> <b>European Directive</b>	<b>Column (2)</b> <b>Commission's Directive</b>
a)	Asset items constituting claims on Zone A central governments or central banks.	Asset items constituting claims on Zone A central governments or central banks.
b)	Asset items constituting claims on the European Communities.	Asset items constituting claims on the European Communities.
c)	Asset items constituting claims carrying the explicit guarantees of Zone A central governments or central banks or of the European Communities.	Asset items constituting claims carrying the explicit guarantees of Zone A central governments or central banks or of the European Communities
d)	Other exposures attributable to, or guaranteed by, Zone A central governments or central banks or the European Communities.	Other exposures attributable to, or guaranteed by, Zone A central governments or central banks or the European Communities.
e)	Asset items constituting claims on and other exposures to Zone B central governments or central banks which are denominated and, where applicable, funded in the national currencies of the borrowers.	Asset items constituting claims on and other exposures to Zone B central governments or central banks which are denominated and, where applicable, funded in the national currencies of the borrowers.
f)	Asset items and other exposures secured, to the satisfaction of the competent authorities, by collateral in the form of Zone A central government or central bank securities, or securities issued by the European Communities or by Member State regional or local authorities for which Article 44 lays down a zero weighting for solvency purposes.	Asset items and other exposures secured, to the satisfaction of the Commission, by collateral in the form of Zone A central government or central bank securities, or securities issued by the European Communities or by Member State regional or local authorities for which a zero weighting for solvency purposes is applied.
g)	Asset items and other exposures secured, to the satisfaction of the competent authorities, by collateral in the form of cash deposits <b>placed with the lending institution or with a credit institution which is the parent undertaking or a subsidiary of the lending institution.</b>	Asset items and other exposures secured, to the satisfaction of the Commission, by collateral for this purpose in the form of cash deposits <b>placed in a credit institution related to the Cypriot Investment Firm on behalf of the latter</b> .
h)	Asset items and other exposures secured,	Asset items and other exposures secured,

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	to the satisfaction of the competent authorities, by collateral in the form of certificates of deposit issued by the <b>lending institution</b> or by a credit institution which is the parent undertaking or a subsidiary of the lending institution and lodged with either of them.	to the satisfaction of the Commission, by collateral in the form of certificates of deposit issued by the lending institution which is parent or subsidiary company of the Cypriot Investment Firm and deposited for this purpose in the Cypriot Investment Firm or in the above lending institution.
i)	Asset items constituting claims on and other exposures to <b>credit institutions</b> , with a maturity of one year or less, but not constituting such institutions' own funds.	Asset items constituting claims on and other exposures to <b>third parties which are not related companies with the Cypriot Investment Firm but are credit institutions, Investment Firms, approved Investment Firms from third countries, approved clearing houses, and approved stock exchanges in which financial instruments are traded</b> , and which the asset items or exposures have a maturity of one year or less deadline, and do not constitute own funds of those institutions.
j)	Asset items constituting claims on and other exposures to those institutions which are not credit institutions but which fulfill the conditions referred to in Article 45(2), with a maturity of one year or less, and secured in accordance with the same paragraph.	Not adopted
k)	Bills of trade and other similar bills, with a maturity of one year or less, bearing the signatures of other credit institutions	Not adopted
l)	Debt securities as defined in Article 22(4) of Directive 85/611/EEC	Not adopted
m)	Pending subsequent coordination, holdings in the insurance companies referred to in Article 51(3) up to 40 % of the own funds of the credit institution acquiring such a holding.	Not adopted
n)	Asset items constituting claims on regional or central credit institutions with which the lending institution is associated in a network in accordance with legal or statutory provisions and which are responsible, under those provisions, for cash-clearing operations within the network	Not adopted
o)	Exposures secured, to the satisfaction of the competent authorities, by collateral in the form of securities other than those referred to in (f) provided that those	Exposures secured, to the satisfaction of the Commission, by collateral in the form of securities other than those referred to in (f) provided that those securities are not

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	<p>securities are not issued by the credit institution itself, its parent company or one of their subsidiaries, or by the client or group of connected clients in question. The securities used as collateral must:</p> <ul style="list-style-type: none"> <li>• Be valued at market price</li> <li>• Have a value that exceeds the exposures guaranteed. The excess value required shall be 100 % it shall, however, be 150 % in the case of shares and 50 % in the case of debt securities issued by credit institutions, Member State regional or local authorities other than those referred to in Article 44, and in the case of debt securities issued by the European Investment Bank and multilateral development banks.</li> <li>• Be either traded on a stock exchange or effectively negotiable and regularly quoted on a market operated under the auspices of recognised professional operators and allowing, to the satisfaction of the competent authorities of the Member State of origin of the credit institution, for the establishment of an objective price such that the excess value of the securities may be verified at any time.</li> <li>• Not constitute credit institutions' own funds.</li> </ul>	<p>issued by the Cypriot Investment Firm, or its parent company or its own subsidiary companies or its parent company, or by the client or group of connected clients and are accomplished the following conditions:</p> <ul style="list-style-type: none"> <li>• Are valued at market price.</li> <li>• The value of the securities used as collateral exceeds the value of the exposures (excess value) per: <ul style="list-style-type: none"> <li>- 150% in the case of shares,</li> <li>- 50% in the case of debt securities issued by IFs, member states regional or local authorities other than those referred to in (f) above, European Investment Bank or multilateral development banks,</li> <li>- 100% in any other case.</li> </ul> </li> <li>• Are effectively negotiable and regularly quoted on a market operated under the auspices of recognised professional operators and allowing, to the satisfaction of the Commission for the establishment of an objective price such that the excess value of the securities may be verified at any time.</li> <li>• Are not constitute credit institutions' own funds.</li> </ul> <p><b>In the case where the exposures are not covered with the up to the above excess value, the exempt amount is lessened so that its balance to be within the above percentages. The uncovered amount, which remains, is taken into consideration 100% when calculating the limits on exposures.</b></p>
p)	Loans secured, to the satisfaction of the competent authorities, by mortgages on residential property or by shares in Finnish residential housing companies, operating in accordance with the Finnish Housing Company Act of 1991 or subsequent equivalent legislation and leasing transactions under which the lessor retains full ownership of the	Not adopted

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	residential property leased for as long as the lessee has not exercised his option to purchase, in all cases up to 50 % of the value of the residential property concerned. The value of the property shall be calculated, to the satisfaction of the competent authorities, on the basis of strict valuation standards laid down by law, regulation or administrative provisions. Valuation shall be carried out at least once a year. For the purposes of this point residential property shall mean a residence to be occupied or let by the borrower.	
q)	50 % of the medium/low-risk off-balance-sheet items referred to in Annex II.	Not adopted
r)	Subject to the competent authorities' agreement, guarantees other than loan guarantees which have a legal or regulatory basis and are given for their members by mutual guarantee schemes possessing the status of credit institutions, subject to a weighting of 20 % of their amount.  Member States shall inform the Commission of the use they make of this option in order to ensure that it does not result in distortions of competition.	Not adopted
s)	The low-risk off-balance-sheet items referred to in Annex II, to the extent that an agreement has been concluded with the client or group of connected clients under which the exposure may be incurred only if it has been ascertained that it will not cause the limits applicable under paragraphs 1, 2 and 3 to be exceeded.	Not adopted